2. Financial Institutions

2.1 Development Finance Institutions (DFIs)

Development Banks

The Reserve Bank of India, in 1945, carried out an extensive study to explore the possibilities of both all India and regional institutions of industrial finance. The proposal passed through several stages and took concrete shape with the establishment of the Industrial Finance Corporation of India (IFCI) in 1948. The IFCI was the first institution of its kind in India and experts say that its establishment "marks the beginning of the era of development banking in India." After the establishment of IFCI in 1948, the Government of India established a series of financial institutions to provide funds to the large industrial sector - the Industrial Credit and Investment Corporation of India (ICICI) in 1955, the Industrial Development Bank of India (IDBI) in 1964, the Industrial Reconstruction Bank of India (IRBI) in 1971 (now called IIBI), the Export and Import Bank of India (EXIM) in 1982, etc. At the state level, the State Financial Corporations (SFCs) and the State Industrial Development Corporations (SIDCs) were set up. All these institutions have come to be known as public sector financial institutions on term-lending institutions. The Narsimham Committee (1991) called these institutions, Development Financial Institutions (DFIs).

A large number of other financial institutions have also been set up due to the initiatives taken by the Government. All financial institutions in India can be divided into the following categories :

1. **All India Development Banks :** Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India Ltd. (IFCI)., Industrial Credit and Investment Corporation of India Ltd. (ICICI), Small Industrial Development Bank of India (SIDBI) and Industrial Investment Bank of India (IIBI).
2. **Specialised Financial Institutions :** Risk Capital and Technology Finance Corporation Ltd. (RCTC), (TDICI) Technology Development and Information Company of India Ltd. and Tourism Finance Corporation of India Ltd. (TFCI).
3. **Investment Institutions :** Unit Trust of India (UTI), Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC) and its subsidiaries.
4. **State Level Institutions :** State Financial Corporations (SFCs) and State Industrial Development Corporations (SIDCs).

1. All India Development Banks

Industrial Finance Corporation of India (IFCI)

The Government of India set up the industrial Finance Corporation of India (IFCI) in July, 1948 under a Special Act. The IDBI, scheduled banks, insurance companies, investment trusts and cooperative banks are the shareholder of IFCI. The Union Government has guaranteed the repayment of capital and the payment of a minimum annual dividend. The corporation is authorised to issue bonds and debentures in the open market, to borrow foreign currency from the World Bank and other organisations, accept deposits from the public and also borrow from the Reserve Bank. Earlier, its role was that of a gap filler as it was not expected to compete with the then prevailing channels of industrial finance. It was only meant to supplement their efforts. With effect from 1st July, 1993, IFCI has been converted into a public limited company and is now known as Industrial Finance Corporation of India Ltd.

Functions : The IFCI grants financial assistance in the following forms :

(1) Granting loans and advances both in rupees and in foreign currencies repayable within 25 years.

(2) Guaranteeing rupee loans floated in the open market by industrial concerns.

(3) Underwriting shares and debentures of the industrial concerns.

(4) Guaranteeing–deferred payments in respect of imports of machinery; foreign currency loans raised from foreign institutions; and rupee loans raised from scheduled banks or State Cooperative banks by industrial concerns.

Features

The monetary situation was characterized by scarcity of funds relative to demand for finance from trade, commerce and industry, particularly as regards long term investment. Under these circumstances the corporation has rendered considerable service to Indian industries:

(1) Industries of very high national priority such as fertilizers, cement, power generation, paper industrial machinery etc. have received assistance from IFCI.

(2) The assistance rendered includes rupee loans, foreign currency loans, underwriting of direct subscription to shares and debentures, deferred payment guarantees and foreign loan guarantees.

(3) IFCI has started new promotional schemes such as :

 (a) Interest subsidy scheme for women entrepreneurs.

 (b) Consultancy fee subsidy schemes for providing marketing assistance to small scale units.

 (c) Encouraging the modernization of tiny, small and ancillary units.

 (d) Control of pollution in the small scale and medium scale industries.

(4) IFCI introduced 2 new schemes during 1988-89. These two schemes of financial assistance were : a scheme of equipment leasing and a scheme for equipment procurement.

(5) IFCI is also diversifying its activities in the field of merchant banking to encompass other financial services, particularly project counselling, syndication of loans, formulation of rehabilitation programmes assignments relating to amalgamation and mergers etc.

(6) IFCI had set up a Risk Capital Foundation (RCF) in 1975 which was later converted to Risk Capital and Technology Foundation (RCTF) in 1998 mainly to promote :

 (a) Risk Capital Scheme

 (b) Technology Promotion Scheme

 (c) Venture Capital Scheme

 (The RCTF has been renamed Venture Capital Fund Ltd.)

(7) Lending of the corporation requires the security of fixed assets. It does not lend against raw materials of finished goods.

(8) The corporation has the right to take over the management of concern or sell the mortgaged property in the event of continuous default, in the payment of interest on principal advanced.

Industrial Credit and Investment Corporation of India Ltd. (ICICI)

The Industrial Credit and Investment Corporation of India (ICICI) was the second all India development bank to be established in the country. It was set up in January, 1955. The ICICI was a private sector development bank. It differed from the IFCI and IDBI is respect of ownership (Both are public sector development banks), management and lending operations. Its distinguishing feature is that it provided underwriting facilities which was generally neglected by other institutions. **The ICICI Ltd. has recently been merged with the ICICI Bank.** The ICICI was sponsored by a mission from the World Bank for the purpose of developing small and medium industries in the private sector. The issued capital of ICICI has been subscribed by Indian banks, insurance companies and individuals and corporations of the USA, the British Eastern exchange banks and other companies and the general public in India.

Functions

(1) To assist expansion and modernisation of existing industries and to furnish technical and managerial aid so as to increase production and afford employment opportunities.

(2) Assists industrial concerns with loans and guarantees in rupees and foreign currency.

(3) Underwrite ordinary and preference shares and debentures and also subscribes directly to them.

(4) Provides provision of foreign currency loan and advance to enable Indian industrial concerns to secure essential capital goods from foreign countries.

(5) ICICI commenced leasing operations in 1983. Provides leasing assistance for computerization, mordernisation, replacement, equipment of energy, pollution control, conservation etc.

Features

(1) Plays a vital role in providing financial assistance to industrial enterprises in the private sectors.

(2) The ICICI distinguishes itself from others in that it provides provision for foreign currency loans.

(3) ICICI commenced leasing operation in 1983.

(4) Set up merchant banking which is working very creditably.

(5) ICICI has set up–ICICI Securities and Finance Co. Ltd. (I-Sec.); Asset Management Co. Ltd. in June, 1993.

(6) Setup subsidiary called–ICICI Mutual Funds; ICICI Investors Fund Ltd., and ICICI Banking Corporation Ltd.

(7) ICICI has promoted the following companies and institutions–Credit Rating Information Services of India Ltd. (CRISIL) in association with UTI; Technology Department and Information Company of India Ltd. (TDICI); Programme for the Advancement of Commercial Technology (PACT) and Programme for Acceleration of Energy Research (PACER), both funded by USAID.

(8) The merger of the ICICI with the ICICI Bank in 2002, has led to the creation of the first universal bank in India.

The Industrial Development Bank of India (IDBI)

The Industrial Development Bank of India is another in the series of specialized institutions set up to provide long-term loans/finance to industry. Many institutions like the IFCI, ICICI, State Finance Corporation, the Refinance Corporation of India etc. have been functioning and providing long-term finance to industry. The volume of long-term finance provided by these institutions has been substantial and has been steadily increasing also, but it was found inadequate to meet the requirements of new and growing industrial enterprises. On one side there was a need for rapid industrialisation necessitating the establishment of a new institution with large financial resources, on the other side there was the need for coordination the activities of all agencies which are concerned with the provision of finance for industrial development. It was fulfil these two objectives that the Government decided to establish the IDBI which came into existence in July, 1964. The IDBI was a wholly owned subsidiary of the RBI till 1976. In 1976 the IDBI was delinked from the RBI and was taken over by the Government of India. In Oct. 1994 IDBI Act was amended to impact its greater operational flexibility and allowed into access capital market through public issue of equity shares. In July, 1995, IDBI made the first public issue of equity share which was the largest issue in the Indian capital market.

Functions

(1) Grants direct assistance by way of project loans, underwriting and direct subscription to industrial securities, soft loans, technical refund loans and equipment finance loans.

(2) Refinance term-loan repayable within 3 to 25 years given by IFCI, SFC and other financial institution; refinance loans repayable between 3 to 10 years given by scheduled banks or state cooperative banks and refinance export credit given by scheduled and state cooperative banks.

(3) The Industrial Development Bank of India Act, 1964, has created a special fund known as the Development Assistance Fund to be used to assist those industrial units which are unable to secure funds because of low rate of return.

(4) The IDBI raised foreign funds from international money markets and funding organisation and makes them available to those industrial units that require them.

(5) The IDBI announced in July, 1969 a scheme for assistance to small and medium projects in backward areas so as to promote industrial development in these areas.

(6) IDBI provides refinance facilities to industrial units through member banks.

(7) IDBI is providing resource support to financial intermediaries, IFCI, SFCs, leasing companies and other financial intermediaries were assisted by IDBI with loans and investment in their shares and bonds.

(8) The IDBI extends assistance to small scale industries through state level institutions and commercial banks, by way of refinance of industrial loans.

(9) IDBI launched the National Equity Fund Scheme in 1988 for providing support. The scheme was administered by IDBI through nationalised banks.

(10) IDBI introduced the single window scheme for grant of term-loans and working capital assistance to new tiny and small scale industries.

Features

(1) IDBI is the leader in the Indian Capital Market.

(2) It has both regulatory and developmental functions.

(3) IDBI promotes and develops industries as per the planned projections of the government.

(4) IDBI operates a number of scheme for benefit of promoting enterprises and concessional finance facilities are also provided for industries in backward areas.

(5) The IDBI as the leader of the market, coordinates, guides and monitors the credit facilities by All-India and State-level financial Institutions and development corporations.

(6) IDBI performs certain promotional function as well. This includes provision for training in project evaluation and development of entrepreneurship.

Small Industries Development Bank of India (SIDBI)

The Small Industries Development Bank of India (SIDBI) was set up by the Government of India under a special Act (1989) of the Parliament in April, 1990. SIDBI as a wholly-owned subsidiary of IDBI took over the outstanding portfolio of IDBI relating to the small scale sector.

Functions

(1) SIDBI refinance loans and advances extended by primary leading institutions to small scale industrial units and also provides resource support to them.

(2) SIDBI discounts and rediscounts bills arising from scale of machinery to or manufactured by industrial unit in the small scale sector.

(3) SIDBI extends seeds capital/soft loans assistance through specified lending securities.

(4) SIDBI grants direct assistance as well as refinance loans extended by primary lending institutions for financing expert of products manufactured by industrial concerns in the small scale sector.

(5) SIDBI provides services like leasing etc. to small scale sector.

(6) SIDBI extends financial support to State Small Industries Development Corporations for providing scarce raw materials to and marketing the end product of industrial units of small scale sector.

(7) SIDBI provides support to National Small Industrial Corporation for providing, leasing, hire purchase and marketing support to individual units of the small scale sectors.

Features

(1) SIDBI has liberalized its terms of assistance and simplified procedures with a view to widen its scope for larger coverage of schemes.

(2) Operates Single Window Scheme which is enlarged to cover units in identified areas.

(3) Provides refinance facilities under Automatic Refinance Scheme (ARS).

(4) SIDBI has introduced equipment financing of assistance to well fun scale units for upgradation and modernisation.

(5) Introduced refinance scheme for the settlement of voluntarily retired workers of National Textile Corporation (NTC).

(6) SIDBI has set up a venture capital fund to assist entrepreneurs.

2. Specialised Financial Institutions (SFIs)

Tourism Finance Corporation or India Ltd. (TFCI): It has been set-up as an All India Financial Institution, pursuant to the recommendations of "National Committee on Tourism" set-up under the aegis of Planning Commission in 1988. The main object of setting-up the specialised financial institution was to expedite the growth of tourism infrastructure in the country by providing dedicated line of credit on long term basis to tourism related projects in the country.

EXIM Bank (Export Import Bank of India): The export import bank of India was established in 1982. The Head office is in Mumbai. It is designed and developed as an apex institution in India for financing promotion and development of exports in the country. The EXIM Bank is a wholly-owned subsidiary of the Indian Government. The key functions of EXIM bank are :

- **Buyer's Credit :** It is a credit facility programme that encourages Indian exporters to explore new regions across the globe. It also facilitates exports for SMEs by offering credit to overseas buyers to import goods from India.
- **Corporate Banking :** It offers a variety of financing programmes to augment the export-competitiveness of Indian companies.
- **Lines of Credit :** It offers extended line of credit to Indian exporters to help them to expand new geographies and use line of credit as an effective market-entry tool.
- **Overseas Investment Finance :** It offers term loans to Indian companies for equity investments in their overseas joint ventures or wholly-owned subsidiaries.
- **Project Exports :** Encourages project exports from India and helps Indian companies to secure contracts abroad.

National Bank for Agriculture and Rural Development (NABARD): National Bank for Agriculture and Rural Development (NABARD) was established on 12 July 1982 by an Act of the Parliament. NABARD, as a Development Bank, is mandated for providing and regulating credit and other facilities for the promotion and development of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities. The Head office is in Mumbai.

The major functions of NABARD include promotion and development, refinancing, financing, planning and monitoring and supervision.

Non-Credit Related Functions :

- Credit Planning and Monitoring, Coordination with various agencies and institutions.
- Assist in policy formulation of GoI, RBI and State Governments on matters related to agricultural credit and rural development.
- Institutional development and capacity building of Cooperatives and Regional Rural Banks (RRBs) to strengthen the rural credit delivery system. Statutory inspection of Regional Rural Banks (RRBs) and State Cooperative Banks and District Central Cooperative Banks (DCCBs) and voluntary inspection of State Cooperative Agriculture and Rural Development Banks (SCARDBs) their off-site surveillance.

- Promotional and developmental initiatives in the areas of farm, off-farm, micro finance, financial inclusion Convergence with Govt. sponsored programmes.
- Supporting the financial inclusion efforts of Regional Rural Banks and Cooperative Banks.
- Thrust on promotion of livelihood opportunities and Micro Enterprises.
- Capacity Building of Personnel and Board Members of Credit Cooperatives and Staff of Rural Financial Institutions.
- Support to research and development, rural innovations, etc.

Credit Related Functions :

- Refinance to Rural Financial Institutions for investment credit (long term loan) and production and marketing credit (short term loan) purposes for farm and off farm activities in rural areas.
- Loans to State Governments for developing rural infrastructure warehousing and strengthening of the Cooperative Credit Structure.
- Loans for warehousing infrastructure to State Governments, State/Central government Owned assisted entities, Cooperatives,Federation of cooperatives. Farmers' Producers Organization, (FPOs), Federations of Farmers' Collectives, Primary Agricultural Credit Societies (PACS) / Cooperative Marketing Societies (CMS) or similar institutions, Corporates/Companies, Individual entrepreneurs, etc.,
- Direct lending to Cooperatives and Producers' Organization, support to State owned institutions/corporations under NABARD Infrastructure Development Assistance and direct lending to individuals, partnership firms, corporates, NGOs, MFls, Farmers' collectives etc. under Umbrella Programme for Natural Resource Management (UPNRM).
- Pass through agency of select Government of India Capital Investment Subsidy Schemes.

National Housing Bank (NHB) : The National Housing Policy, 1988 envisaged the setting up of National Housing Bank NHB as the Apex level institution for housing. In pursuance of the above, NHB was set up on July 9, 1988 under the National Housing Bank Act, 1987. Reserve Bank of India contributed the entire paid-up capital.

The Head Office of NHB is at New Delhi.

The basic functions of the NHB are to operate as a principal agency to promote housing finance institutions both at local and regional levels.

Other Specialized financial institutions include Power Finance Corporation, Indian Railway Finance Corporation (1986), Indian Renewable Energy Development Agency (1987) etc.

3. Investment Institutions

These are the most popular form of financial intermediaries, which particularly catering to the needs of small savers and investors. They deploy their assets largely in marketable securities.

Life Insurance Corporation of India (LIC) : It was established in 1956 as a wholly-owned corporation of the Government of India. It was formed by the Life Insurance Corporation Act, 1956, with the objective of spreading life insurance much more widely and in particular to the rural area. It also extends assistance for development of infrastructure facilities like

housing, rural electrification, water supply, sewerage, etc. In addition, it extends resource support to other financial institutions through subscription to their shares and bonds, etc.

Unit Trust of India (UTI) : It was set up as a body corporate under the UTI Act, 1963, with a view to encourage savings and investment. It mobilises savings of small investors through sale of units and channelises them into corporate investments mainly by way of secondary capital market operations.

General Insurance Corporation of India (GIC) : It was formed in pursuance of the General Insurance Business (Nationalisation) Act, 1972 (GIBNA), for the purpose of superintending, controlling and carrying on the business of general insurance or non-life insurance.

Initially, GIC had four subsidiary branches, namely, National Insurance Company Ltd, The New India Assurance Company Ltd, The Oriental Insurance Company Ltd and United India Insurance Company Ltd. But these branches were delinked from GIC in 2000.

It was the only **reinsurance company** in the Indian insurance market until the insurance market was open to foreign reinsurance players by late 2016.

National Small Industries Corporation (NSIC) : The National Small Industries Corporation Ltd. was established in 1955 by the Government of India as per the recommendations of the International Planning Team of Ford Foundation, its objectives are to aid, assist, counsel, finance, protect and promote the industries in the country. The NSIC assists small scale industries through its various schemes such as hire purchase, equipment leasing, marketing, export, raw material assistance and single point registration scheme.

4. State level Institutions

State Financial Corporations (SFCs) : State Financial Corporations Act, 1951 was enacted by the Parliament to provide institutional framework for financing medium and small-scale industries, which fell outside the operational scope of IFCI. After enactment of the Act, SFCs were set up in the various States over a period of time. The Act provides special role for the State Governments in the promotion and management of the affairs of the SFCs.

There are 18 SFCs of which 17 were set up under the SFC Act. 1951, while the Tamil Nadu Industrial Investment Corporation Ltd. was incorporated under the Companies Act, 1956 but still functions as SFC. Their main objectives are to finance and promote small and medium enterprise in the States concerned for achieving balanced regional growth, catalyse investment, generate employment and widen the ownership base of industries by way of providing term loans, direct subscription to equity/debentures, extending guarantees, discounting of bills and providing special/seed capital, etc.

The first State Finance Corporation was set up in Punjab in 1953.

State Industrial Development Corporations (SIDCs) : These have been established under the erstwhile Companies Act, 1956, as wholly-owned undertakings of State Governments. They have been set up with the aim of promoting industrial development in the respective States and providing financial assistance to small entrepreneurs. They are also involved in setting up of medium and large industrial projects in the joint sector/assisted sector in collaboration with private entrepreneurs or wholly-owned subsidiaries. They are undertaking a variety of promotional activities such as preparation of feasibility reports; conducting industrial potential surveys; entrepreneurship training and development programmes; as well as developing industrial areas/estates.

2.2 Non-Banking Financial Companies (NBFCs)

Non-bank financial companies (NBFCs) are financial institutions that provide some of the banking services without the definition of a bank since it do not hold a banking license. NBFCs are companies registered under the Companies Act, 2013 engaged in the business of loans and advances, acquisition of shares, stocks, bonds, debentures or securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business and chit fund business.

NBFCs can be classified into two broad categories :

- NBFCs accepting public deposit (they hold a deposit accepting certificate of registration).
- NBFCs not accepting/holding public deposit (they do not hold such a certificate).

To Accept Deposits

- A Non Banking Financial Company has to be registered with the RBI and have certificates of authorization to accept deposits from the public.
- An NBFC must show the certified copy for accepting deposits at the registered office and other branches.
- An NBFC registered with the RBI merely authorizes it to conduct the business of an NBFC. NBFCs cannot use the name of the RBI in any manner while conducting their business.
- The NBFC whose application for the authorization certificate for accepting deposits has been rejected by the Reserve Bank of India cannot accept fresh deposits neither can it renew existing deposits.

Difference between BANK & NBFC

- NBFCs lend and make investments and hence their activities are similar to that of banks. However there are a few differences as given below:
- NBFC cannot accept demand deposits.
- NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself.
- Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

Relation with RBI

A company which comes under the Companies Act, 2013 and desirous of commencing business of non-banking financial institution as defined under Section 45 IA of the RBI Act, 1934 should comply with the following :

- The company should be registered under Section 3 of the companies Act, 1954.
- It should have a minimum net owned fund of Rs 200 lakhs.

Deposits

- The interest may be paid or compounded at rests not shorter than monthly rests.
- The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months.
- They cannot accept deposits repayable on demand.
- The deposits with NBFCs are not insured.

- The Reserve Bank of India does not ensure the repayment of deposits by NBFCs.

Minimum capital required for setting up an NBFC : 100 crore

Type of NBFC

Asset Finance Company(AFC) : The main business of these companies is to finance the assets such as machines, automobiles, generators, material equipments, industrial machines etc.

Investment Company (IC) : The main business of these companies is to deal in securities.

Loan Companies (LC) : The main business of such companies is to make loans and advances (not for assets but for other purposes such as working capital finance etc.)

Infrastructure Finance Company (IFC) : A company which has net owned funds of at least Rs. 300 Crore and has deployed 75% of its total assets in Infrastructure loans is called IFC provided it has credit rating of A or above and has a CRAR of 15%.

Systemically Important Core Investment Company (CIC-ND-SI) : A systematically important NBFC (assets Rs. 100 crore and above) which has deployed at least 90% of its assets in the form of investment in shares or debt instruments or loans in group companies is called Out of the 90%, 60% should be invested in equity shares or those instruments which can be compulsorily converted into equity shares. Such companies do accept public funds.

Infrastructure Debt Fund (IDF-NBFC) : A debt fund means an investment pool in which core holdings are fixed income investments. The Infrastructure Debt Funds are meant to infuse funds into the infrastructure sector. The importance of these funds lies in the fact that the infrastructure funding is not only different but also difficult in comparison to other types of funding because of its huge requirement, long gestation period and long term requirements.

In India, an IDF can be **set up either as a trust or as a company. If the IDF is set up as a trust,** it would be a mutual fund, regulated by SEBI. Such funds would be called **IDF-MF**. The mutual fund would issue rupee-denominated units of five years' maturity to raise funds for the infrastructure projects.

If the IDF is set up as a company. It would be an NBFC; it will be regulated by the RBI. The IDF guidelines of the RBI came in September 2011. According to these guidelines, such companies would be called **IDF-NBFC.**

An IDF-NBFC is a non-deposit taking NBFC that has Net Owned Fund of Rs 300 crores or more and which invests only in Public Private Partnerships (PPP) and post commencement operations date (COD) infrastructure projects which have completed at least one year of satisfactory commercial operation and becomes a party to a Tripartite Agreement.

Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI)

NBFC-MFI is a non-deposit taking NBFC which has at least 85% of its assets in the form of microfinance. Such microfinance should be in the form of loan given to those who have annual income of Rs. 60,000 in rural areas and Rs. 120,000 in urban areas. Such loans should not exceed Rs. 50000 and its tenure should not be less than 24 months. Further, the loan has to be given without collateral. Loan repayment is done on weekly, fortnightly or monthly installments at the choice of the borrower.

Non-Banking Financial Company - Factors (NBFC-Factors)

Factoring business refers to the acquisition of receivables by way of assignment of such receivables or financing, there against either by way of loans or advances or by creation of security interest over such receivables but does not include normal lending by a bank against the security of receivables etc. An NBFC-Factoring company should have a minimum Net Owned Fund (NOF) of Rs. 5 Crore and its financial assets in the factoring business should constitute at least 75 percent of its total assets and its income derived from factoring business should not be less than 75 percent of its gross income.

Hedge Funds

Hedge funds are alternative investments using pooled funds that employ different strategies to earn active return, or alpha, for their investors. Hedge funds may be aggressively managed or make use of derivatives and leverage in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark). It is important to note that hedge funds are generally only accessible to accredited investors as they require less SEC regulations than other funds. One aspect that has set the hedge fund industry apart is the fact that hedge funds face less regulation than mutual funds and other investment vehicles.

Each hedge fund is constructed to take advantage of certain identifiable market opportunities. Hedge funds use different investment strategies and thus are often classified according to investment style. There is substantial diversity in risk attributes and investments among styles.

Legally, hedge funds are most often set up as private investment limited partnerships that are open to a limited number of accredited investors and require a large initial minimum investment. Investments in hedge funds are illiquid as they often require investors to keep their money in the fund for at least one year, a time known as the lock-up period. Withdrawals may also only happen at certain intervals such as quarterly or bi-annually.

- Hedge funds are alternative investment vehicles that employ a variety of strategies to generate alpha for their accredited investor clients.
- They are more expensive as compared to conventional investment instruments because they have a Two And Twenty fee structure, meaning they charge two percent for asset management and take 20% of overall profits as fees.
- They have an exceptional growth curve in the last twenty years and have been associated with several controversies.

Characteristics of Hedge Funds

- **They're only open to "accredited" or qualified investors :** Hedge funds are only allowed to take money from "qualified" investors-individuals with an annual income that exceeds $200,000 for the past two years or a net worth exceeding $1 million, excluding their primary residence. As such, the Securities and Exchange Commission deems qualified investors suitable enough to handle the potential risks that come from a wider investment mandate.

- **They offer wider investment latitude than other funds :** A hedge fund's investment universe is only limited by its mandate. A hedge fund can basically invest in anything-land, real estate, stocks, derivatives, and currencies. Mutual funds, by contrast, they have to basically stick to stocks or bonds and are usually long-only.
- **They often employ leverage :** Hedge funds will often use borrowed money to amplify their returns. As we saw during the financial crisis of 2008, leverage can also wipe out hedge funds.
- **Fee structure :** Instead of charging an expense ratio only, hedge funds charge both an expense ratio and a performance fee. This fee structure is known as "Two and Twenty"-a 2% asset management fee and then a 20% cut of any gains generated.

RISKS of Hedge Funds

- Concentrated investment strategy exposes hedge funds to potentially huge losses.
- Hedge funds typically require investors to lock up money for a period of years.
- Use of leverage, or borrowed money, can turn what would have been a minor loss into a significant loss.

Pension Fund

In 1999 the Government of India commissioned a national project, OASIS (an acronym for “old age social and income security”), to examine policies related to old age income security in India. Based on the recommendations of the OASIS report, the Government of India introduced a new Defined Contribution Pension System for the new entrants to Central/State Government service, except for the armed forces, replacing the existing system of the Defined Benefit Pension System.

On 23 August 2003, the Interim Pension Fund Regulatory & Development Authority (PFRDA) was established through a resolution by the Government of India to "promote old age income security by establishing, developing and regulating pension funds, to protect the interests of subscribers to schemes of pension funds and for matters connected therewith or incidental thereto.” The Pension Fund Regulatory & Development Authority Act was passed on 19 September 2013 and notified on 1 February 2014, thus setting up PFRDA as the regulator for pension sector in India.

The contributory pension system was notified by the Government of India on 22 December 2003, now named as the **National Pension System (NPS)** with effect from 1 January 2004. The NPS was subsequently extended to all citizens of the country with effect from 1 May 2009, including self-employed professionals and others in the unorganized sector on a voluntary basis.

Types of Pensions

Pensions broadly divided into two sector:

(A) Formal sector Pensions

(B) Informal sector Pensions

(A) Formal Sector Pensions : The formal sector pensions in India can be divided into 3 categories:

(i) *Those schemes that come under an Act or Statute:* There are three defining Acts for pensions in India:

(a) Pensions under the EPF&MP Act 1952: These include the Employees Provident Fund. Employees Pension Scheme, and Employees Deposit Linked Insurance Scheme.

(b) Pensions under the Coal mines PF&MP Act 1948: These include Coal mines provident fund, Coal mines pension scheme & Coal mines linked insurance scheme.

(c) Gratuity under the Payment of Gratuity Act, 1972.

There are other provident funds in India like Assam Tea Plantations PF, J&K PF, and Seamen's PF etc.

(ii) *Government pensions*: The Government pensions in India are defined under the Directive Principles of State policy and are therefore not under a Statute. The Government amended the regulations to put in place the new pension system. The old scheme continues for the existing employees (i.e. those who joined service prior to January l, 2004). Pensions for government employees would include employees of the central as well as the state governments.

(a) Central Government Pensions like Civil servants pensions, Defenses, Railways, Posts.

(b) State Government Pensions

Bank pensions like Reserve Bank of India (RBI), Public Sector Banks, National Bank for Agriculture and Rural Development (NABARD) and other banks pensions.

(iii) *Voluntary pensions*: Superannuation schemes are also sold in the market. These are typically plans sold by Mutual funds and Insurance companies (Life Insurance & Postal Life Insurance).

(B) Informal Sector Pensions: The Government has stepped up its efforts to extend coverage of formal pension arrangements to the nearly 350 million informal sector workers.

Pension Funds

Pension Fund means a fund established by an employer to facilitate and organize the investment of employees' retirement funds contributed by the employer and employees. The pension fund is a common asset pool meant to generate stable growth over the long term, and provide pensions for employees when they reach the end of their working years and commence retirement.

Pension funds are commonly run by some sort of financial intermediary for the company and its employees, although some larger corporations operate their pension funds in-house. Pension funds control relatively large amounts of capital and represent the largest institutional investors in many nations. Pension funds now a days in India play a huge role in development of the economy and it plays active role in the Indian equity markets. A change both in their investment attitudes and in the regulatory climate, encouraging them to increase their investment

levels in equities and would have a massive impact on capital market and on the economy as a whole.

Since early withdrawal of funds is usually restricted or forbidden, pension funds have long term liabilities, allowing holding of high risk and high return instruments. Accordingly. monies are intermediated by pension funds into a variety of financial assets, which include corporate equities, government bonds, real estate, corporate debt (in the form of loans or bonds), securitized loans, foreign holdings of the instruments mentioned above and money market instruments and deposits as forms of liquidity.

Following are the features of Pension funds:

(a) Risk pooling for small investors. By this they provide a better trade-off of risk and return than for direct holdings;

(b) Premium on diversification, both by holding a spread of domestic securities (which may be both debt and equity) and also by international investment;

(c) Preference for liquidity, and hence for large and liquid capital markets, which trade standard or 'commoditized' instruments;

(d) Ability to absorb and process information, superior to that of individual investors in the capital market;

(e) Large size and thus economies of scale, which result in lower average costs for investors;

(t) Countervailing power which may be used to reduce transactions costs and custodial fees.

Pension Fund Regulatory and Development Authority (PFRDA)

Pension Fund Regulatory and Development Authority was established with the President's assent on 19 September 2013 and was made a permanent Act. The President was the guardian of PFRDA till Financial Year 2014-15 and it has become fully autonomous and functions independently from FY 2014-15. It is a Central autonomous body and is a quasi-government organization and has executive, legislative and judicial powers similar to other financial sector regulators in India such as Reserve Bank or India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority (IRDA) and, Insolvency and Bankruptcy Board of India (IBBI).

Following are the function of Pension Fund Regulatory and Development Authority:

- Regulate NPS and pension schemes to which PFRDA Act applies
- Establish, develop and regulate pension funds
- Protect the interest of pension fund subscribers
- Register and regulate intermediaries
- Approve schemes, terms and conditions. And laying down norms for management of corpus of pension funds
- Establish grievance redressal mechanism for subscribers
- Promote professional organization connected with the pension system
- Settle disputes among intermediaries and also between intermediaries and subscribers

- Train intermediaries and educate subscribers and the general public with respect to pension, retirement savings and related issues
- Regulate the regulated assets
- Call for information, conduct investigation and audit of intermediaries and other entities connected with pension funds

NPS Architecture

The NPS architecture consists of the following entities:

l. NPS Trust, which is entrusted with safeguarding subscribers' interests. National Pension System Trust (NPST) was established by PFRDA as per the provisions of the Indian Trusts Act of 1882 for taking care of the assets and funds under the NPS in the best interest of the subscribers. The powers, functions and duties of NPS Trust are laid down under the PFRDA (National Pension System Trust) Regulations 2015.

2. Central Record keeping Agencies (CRAs) which maintains the data and records, performs the following list of functions:

- Registration of Subscribers and issuance of Permanent Retirement Account Number.
- Dispatch of PRAN card, IPIN/TPIN and Welcome Kit.
- Digitization and maintenance of Subscriber record/preferences.
- Updating Subscriber record/preferences based on requests made for change/ revision.

The CRAs are: NSDL e-Governance Infrastructure Limited and Karvy Computer share Private Limited.

3. Point of Presence (POP) are collection, distribution and servicing arms. The functions includes subscriber registration, processing of initial contribution, processing of regular contribution, changes in subscriber details, grievance handling etc.

4. Pension fund managers (PFM) for managing the investments of subscribers act as, a custodian to take care of the assets purchased by the fund managers. The Pension Fund functions in accordance with the terms of the Letter of Appointment and the Regulations issued by Authority from time to time.

5. Trustee bank to manage the banking operations. Trustee Bank as an intermediary is responsible for the day-to-day flow of funds and banking facilities in accordance with the guidelines/directions issued by the Authority under NPS. It receives NPS funds from all Nodal Offices and transfers the same to the Pension Funds/Annuity Service Providers/other intermediaries as per the operational guidelines.

Axis Bank Ltd. has been appointed as Trustee Bank under NPS by PFRDA w.e.f. 1st July, 2015. The appointment of Trustee Bank is valid for five (5) years subject to annual review by PFRDA.

6. Annuity Service Providers (ASPs) are to be appointed by PFRDA, to maintain the annuity contribution of subscribers through their various schemes. Subscribers will have the option to invest their amount into one annuity scheme upon retirement/resignation. ASPs would be responsible for delivering a regular monthly pension (annuity) to the subscriber for the rest of his/her life.

Currently, 5 Annuity Service Providers have been appointed:

1. Life Insurance Corporation of India
2. HDFC Life Insurance Co. Ltd
3. ICICI Prudential Life Insurance Co. Ltd
4. SBI Life Insurance co. Ltd
5. Star Union Dai - ichi Life Insurance Co. Ltd

7. Subscribers: An Indian citizen between the age of 18-65 years, whether resident or non-resident. can join NPS either as an individual or as an employer-employee group subject to KYC documentation and submission of relevant information. Once you have attained 65 years of age, you cannot further contribute to the NPS accounts.

In Nov 2017, the PFRDA increased the maximum age of joining under NPS-Private Sector (i.e. All Citizen and Corporate Model) from 60 years to 65 years of age. Now, any Indian Citizen, resident or non-resident, between the age of 60-65 years, can also join NPS and continue up to the age of 70 years in NPS. With this increase of joining age, the subscribers who are willing to join NPS at the later stage of life will be able to avail the benefits of NPS.

The subscribers receive a Permanent Retirement Account Number (PRAN) card which has a 12-digit unique number. The numbers of subscribers as on 28th February 2019 are 1.23 Crores.

NPS is a market linked, defined-contribution product that needs you to invest regularly in the funds of your choice. Being a market-linked product, returns are based on the performance of the fund that you choose.

As on May 2019, the number of pension fund managers (PFM) is 8, given below:

1. SBI Pension Funds
2. LIC Pension Fund
3. UTI Retirement Solutions
4. HDFC Pension Fund
5. ICICI Prudential Pension Fund
6. Kotak Pension Fund
7. Reliance Capital Pension Fund
8. Birla Sun Life Pension Management Ltd.

No investments allowed in the following:

(a) International Securities - Strict Capital Account Controls exist in India. No Indian citizen or corporate can invest overseas.

(b) Stocks — India has a large stock market

(c) Real Estate — Only Financial Assets allowed

(d) Gold — Only Financial Assets allowed

(e) No investments permitted in Bank or Corporate Deposits

(f) Investment allowed only in marketable securities

(g) No loans to Individuals or Corporate

(h) Only exception is Central Government's Special Deposits

Recent developments

Until now, private sector subscribers could choose who will manage their NPS corpus from among the 8 pension fund managers under NPS, the pension savings of government subscribers was mandatorily split equally between three public sector pension fund managers—SBI Pension Funds Pvt. Ltd, LIC Pension Fund Ltd and UTI Retirement Solutions Ltd.

Through a notification dated 31 January 2019, the PFRDA permitted the Central government employees to choose their own pension fund manager from among the 8 fund managers under NPS. Government employees can also decide the funds they want to invest in and in what percentage, within the conditions laid out under NPS.

The same notification has also given government employees the freedom to choose between four types of asset allocations, which are:

(A) Existing asset allocation (with equity capped at 15%);

(B) 100% in Government Bonds;

(C) Conservative Lifecycle Fund with equity allocation capped at 25%; and

(D) Moderate Lifecycle Fund with equity allocation capped at 50%.

In effect, government subscribers can now increase their equity exposure. Earlier, their contributions were invested only in option A mentioned above, where equity was capped at 15%.

The subscriber can choose to invest either, wholly or in combination. From the four types of investment schemes offered by the pension fund managers. These are:

1. Scheme E (equity) which allows up to 75% equity participation, this is invested in stocks. (limited was increased from 50% to 75% in Oct 2018)
2. Scheme C (corporate debt) which invests only in high-quality corporate bonds (100% limit).
3. Scheme G (government/Gilt bonds) which invests only in government bonds (100% limit).
4. Scheme A (Alternative Investment) which allows up to 5% (Newly added asset class only for private sector subscriber with active choice)

Alternatively, the subscriber can opt for the default scheme, where his portfolio is rebalanced each year for the proportion of equity, corporate bonds, and government bonds as per the time left to retirement.

NPS offers 2 types of accounts to its subscribers:

Tier I : The primary account, which is a pension account with restrictions on withdrawals and utilization of accumulated corpus. All the tax breaks that NPS offers are applicable only to Tier I accounts.

Tier II : In order to introduce some liquidity to the scheme, the PFRDA allows for a Tier II account where subscribers with pre-existing Tier I accounts can deposit and withdraw money as and when they want. NPS Tier II is an investment account, similar to a mutual fund in characteristics. The contribution to voluntary savings account (also called Tier-II account) can only be made by the subscriber and not by any third party.

Withdrawal

At any point in time before 60 years of Age: Subscriber would be required to invest at least 80% of the pension wealth to purchase a life annuity from any IRDA regulated life insurance company. Rest 20% of the pension wealth may be withdrawn as lump sum.

On attaining the Age of 60 years and upto 70 years of age: At exit subscriber would be required to invest minimum 40 percent of his accumulated savings (pension wealth) to purchase a life annuity from any IRDA regulated life insurance company.

Subscriber may choose to purchase an annuity for an amount greater than 40 percent. The remaining pension wealth can either be withdrawn in a lump sum on attaining the age of 60 or in a phased manner, between age 60 and 70, at the option of the subscriber.

In case of phased manner subscriber has to withdraw minimum 10% of the pension wealth (lump sum amount) every year. Any amount lying to the credit at the age of 70 should be compulsorily withdrawn in lump sum.

Death due to any cause: In such an unfortunate event, option will be available to the nominee to receive 100% of the NPS pension wealth in lump sum.

Atal Pension Yojana

To encourage people from the unorganised sector to voluntarily save for their retirement the Central Government launched a co-contributory pension scheme, 'Swavalamban Pension Scheme' in the Union Budget of 2010-11. Under Swavalamban Pension Scheme, the government will contribute a sum of Rs. 1,000 to each eligible NPS subscriber who contributes a minimum of Rs. 1,000 and maximum Rs. 12,000 per annum. The scheme targets the unorganized sector of the country. The government used to contribute an amount of Rs. 1000 every year for people who had their National Pension Scheme (NPS) accounts, which were funded by the grants of the government itself.

The Atal Pension Yojana replaced the Swavalamban yojana, and was thus launched in May 2015. The National Pension Scheme later got replaced with Atal Pension Yojana which allowed subscription to anyone who is a citizen of India and falls under the age group of 18 to 40 years. The scheme provides pension up to Rs. 5000 a month when a person reaches 60 years of age.

You are eligible to avail the benefits provided to you by Atal Pension Yojana if:

1. You are a citizen of India.
2. You fall under the age group of 18 to 40 years.
3. You will be able to make contributions for at least 20 years.
4. You have a bank account that is linked to your Aadhar.
5. You have a valid mobile number.

Also, people who were registered under Swavalamban yojana will automatically be able to get benefits under Atal Pension Yojana too. Payment of pension and exit from the Pension Yojana is not allowed, except in situations like terminal disease or death of the account holder.

The amount that is to be contributed will depend on:

1. The age at which you register yourself for the pension yojana.
2. The pension slab you opt for, ranging from Rs. 1000 to Rs. 5000.
3. The time of contribution you choose amidst monthly, half-yearly, or quarterly.

If you register yourself at the age of 18 years, you will have to make a monthly contribution of Rs 42. But, if you register yourself at the age of 40, you'll be required to make a monthly contribution of Rs 291. In a similar manner, if you opt for joining the slab of Rs 5000 pension per month at the age of 18 years, you'll have a make a monthly contribution of Rs 210 and of Rs 1454 if you join at the age of 40 years.

NPS Lite

The NPS-Lite is basically designed with the intention to secure the future of the people who are economically disadvantaged and who are not financially well to do. The Pension Fund Regulatory and Development Authority (PFRDA) have introduced the National pension System Lite (NPS-Lite) with effect from April 01, 2010.

The servicing model of NPS Lite is based on group servicing. The people forming part of this low income groups will be represented through their organizations known as "Aggregators" who would facilitate in subscriber registration, transfer of pension contributions and subscriber maintenance functions. Subscribers in the age group of 18 to 60 can join NPS - Lite through the aggregator and contribute till the age of 60.

Pradhan Mantri Shram Yogi Maan-dhan (PM-SYM) Scheme

The Government had launched a mega pension scheme for the unorganised sector in the interim Budget 2019. The scheme would ensure old age protection for the workers in this sector. The category of unorganised workers include agricultural workers, construction workers, beedi workers, home-based workers, street vendors, mid-day meal workers, head loaders, brick kiln workers, cobblers, rag pickers, domestic workers, washermen, rickshaw pullers, landless labourers, handloom workers, leather workers, audio-visual workers and similar other occupations whose monthly income is Rs 15,000/ per month or less and belong to the entry age group of 18-40 years. These people should not be under the New Pension Scheme (NPS), Employees' State Insurance Corporation (ESIC) scheme or Employees' Provident Fund Organisation (EPFO). Further, he/she should not be an income taxpayer.

The following benefits lies under the scheme which can be availed by the contributors;

(i) **Minimum Assured Pension:** After attaining the age of 60 years, each subscriber under the PM-SYM, shall receive minimum assured pension of Rs 3000/- per month.

(ii) **Family Pension:** The criteria for the same falls under the condition if subscriber dies, the spouse will receive the pension which will be 50% of the pension amount. No other person is applicable for the same.

(iii) **Benefits:** If a beneficiary has given regular contribution and died due to any cause (before age of 60 years), his/her spouse will be entitled to join and continue the scheme subsequently by payment of regular contribution or exit the scheme as per provisions of exit and withdrawal.

The contribution of subscriber to PM-SYM shall be made through 'auto-debit' facility from his/ her savings bank account/ Jan- Dhan account. The amount for the same is given by the subscriber from the date of joining till the age of 60 years.

The PM-SYM is a voluntary and contributory pension scheme on 50:50 basis where prescribed age-specific contribution shall be made by the beneficiary and the matching contribution by the Central Government. The subscriber will be required to have a mobile phone, savings bank account and Aadhaar number. The eligible subscriber may visit the nearest Common Services Centers (CSC e-Governance Services India Limited (CSC SPV)) and get enrolled

for PM-SYM using Aadhaar number and savings bank account/Jan-Dhan account number on self-certification basis.

LIC will be the Pension Fund Manager and responsible for Pension pay out. The amount collected under PM-SYM pension scheme shall be invested as per the investment pattern specified by Government of India. PM-SYM will be a Central Sector Scheme administered by the Ministry of Labour and Employment and implemented through Life Insurance Corporation of India and CSC e-Governance Services India Limited (CSC SPV). LIC will be the Pension Fund Manager and responsible for Pension pay out. The amount collected under PM-SYM pension scheme shall be invested as per the investment pattern specified by Government of India.

2.4 Mutual Fund

A Mutual Fund is a collective investment vehicle formed with the specific objective of raising money from a large number of individuals and investing it according to a pre-specified objective, with the benefits accrued to be shared among the investors on a pro-rata basis in proportion to their investment.

> *“ **According to Securities and Exchange Board of India Regulations, 1996** a mutual fund means "a fund established in the form of trust to raise money through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments".*

> *“ "Mutual funds are open end investment companies that invest shareholders' money in portfolio or securities. They are open ended in that they normally offer new shares to the public on a continuing basis and promise to redeem outstanding shares on any business day."*
>
> ***- Encyclopedia Americana***

> *“ **According to AMFI (Association of Mutual Fund in India)** A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares debentures and other securities. The income earned through these investments and the capital appreciation realized are shared by its unit holders in proportion to the number of units owned by them.*

Definition has been further extended by allowing mutual funds to diversify their activities in the following areas :

- Portfolio management services
- Management of offshore funds. Providing advice to offshore funds
- Management of pension or provident funds
- Management of venture capital funds
- Management of money market funds
- Management of real estate funds

The income earned through these investments and the capital appreciation realised are shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest

in a diversified, professionally managed basket of securities at a relatively low cost.

The flow chart below describes broadly the working of a mutual fund :

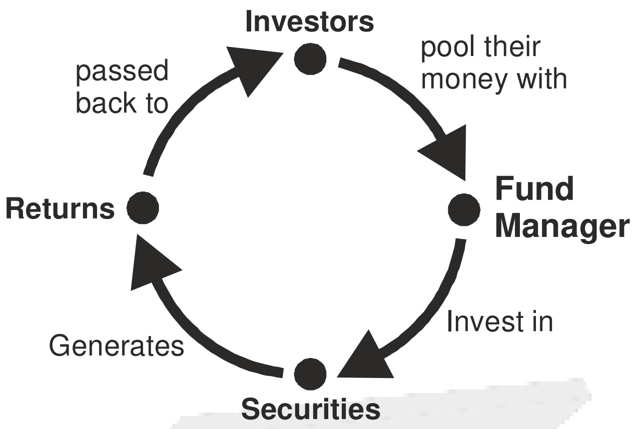


Fig. : Mutual Fund Operation Flow Chart

Net Assets Value

Net asset value (NAV) is the value of an entity's assets minus the value of its liabilities, often in relation to open-end or mutual funds, since shares of such funds registered with Securities and Exchange Board of India (SEBI) are redeemed at their net asset value.

It is a simple calculation – just take the current market value of the fund's net assets (securities held by the fund minus any liabilities) and divide by the number of shares outstanding.

Net asset value (NAV) is the value of a fund's asset less the value of its liabilities per unit.

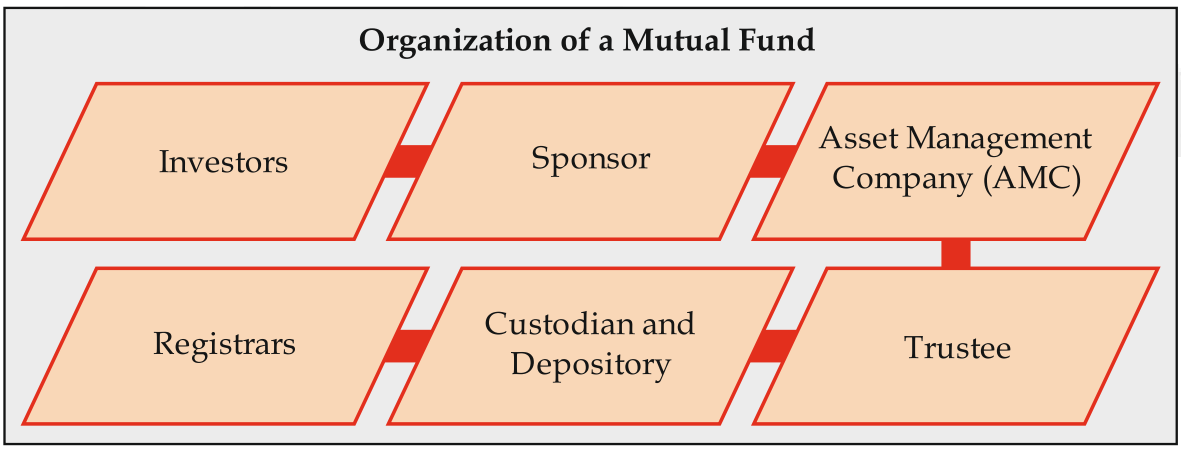
NAV = (Value of Assets-Value of Liabilities)/number of units outstanding.

NAV is often associated with mutual funds, and helps an investor to determine if the fund is overvalued or undervalued.

The adjusted net asset method is a business valuation technique that changes the stated values of a company's assets and liabilities to reflect their estimated current fair market values better.

Organization of a Mutual Fund

There are many entities involved and the diagram below illustrates the organizational set up of a mutual fund :



(i) Investors : Every investor, given his/her financial position and personal disposition, has a certain inclination to take risk. The hypothesis is that by taking an incremental risk, it would be possible for the investor to earn an incremental return. Mutual fund is a solution for investors who lack the time, the inclination or the skills to actively manage their investment risk in individual securities. They delegate this role to the mutual fund, while retaining the right and the obligation to monitor their investments in the scheme.

(ii) Sponsor : Sponsor is the company, which sets up the Mutual Fund as per the provisions laid down by the Securities and Exchange Board of India (SEBI). SEBI mainly fixes the criteria of sponsors based on sufficient experience, net worth, and past track record.

Sponsor can be Indian companies, banks or financial institutions, foreign entities or a joint venture between two entities. As Reliance mutual fund has been sponsored fully by an Indian entity. Whereas, funds like Fidelity mutual fund and J P Morgan mutual fund are sponsored fully by foreign entities. ICICI Prudential mutual fund has been set up as a joint venture between ICICI Bank and Prudential plc. Both sponsors have contributed to the capital of the Asset Management Company of ICICI Prudential.

(iii) Asset Management Company (AMC) : Asset Management Company is the body engaged to run the show of a mutual fund. The AMC manages the funds of the various schemes and employs a large number of professionals for investment, research and agent servicing.

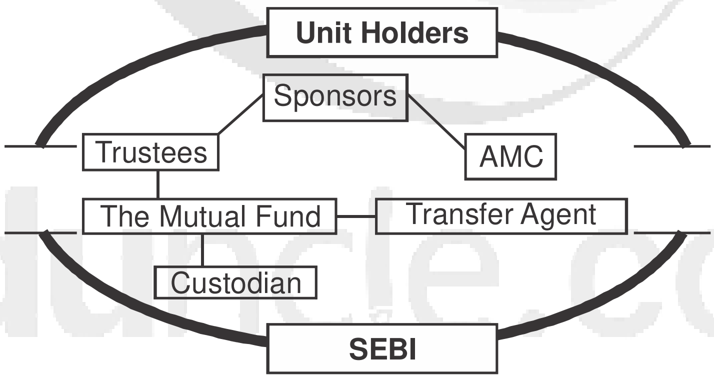
AMC is involved in basically three activities as portfolio management, investment analysis and financial administration. Therefore, the directors of AMC should be expert in these fields.

SEBI has issued the following guidelines for the formation of AMCs :

(a) An AMC should be headed by an independent non-interested and nonexecutive chairman.

(b) The managing director and other executive staff should be full-time employees of AMC.

(c) Fifty per cent of the board of trustees of AMC should be outside directors who are not in any way connected with the bank.



(d) The board of directors shall not be entitled to any remuneration other than the sitting fees.

(e) The AMCs will not be permitted to conduct other activities such as merchant banking or issue management.

(iv) Trustee : Under the Indian trust act 1882, a sponsor creates mutual fund trust, which is the main body in creation of mutual funds. Trustees may be appointed as an individual or as a trustee company with the prior approval of SEBI. As defined under the SEBI regulations, 1996, trustees mean board of trustees or Trustee Company who hold the property of mutual fund for the benefit of the unit holders.

Trustees are an important link in the working of any mutual fund. They are responsible for ensuring that investors' interests in a scheme are taken care properly. They do this by a constant monitoring of the operations of the various schemes. In return for their services, they are paid trustee fees, which are normally charged to the scheme.

(v) Custodian and Depository : The custodian maintains custody of the securities in which the scheme invests. This ensures an ongoing independent record of the investments of the scheme. The custodian also follows up on various corporate actions, such as rights, bonus and dividends declared by investee companies.

SEBI regulations provide for the appointment of a custodian by trustees of the mutual fund who are responsible for carrying on the activities of safe keeping of securities and participating in any clearing system on behalf of mutual fund.

Custodian is not permitted to act as a custodian of more than one mutual fund without the prior approval of SEBI. They should be independent of the sponsors. As for example, ICICI Bank is a sponsor of ICICI Prudential Mutual fund. It is also a custodian bank. But it cannot offer its services to ICICI Prudential Mutual fund, because it is a sponsor of this fund.

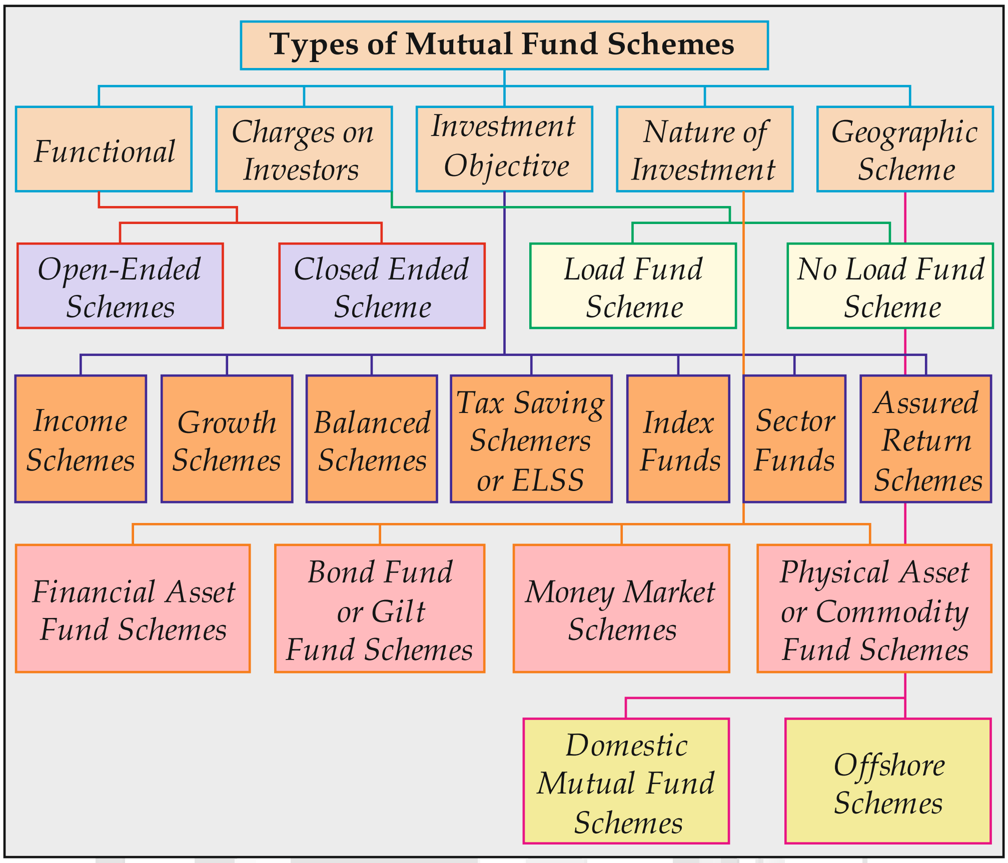
(vi) Registrars : An investor's holding in mutual fund schemes is typically tracked by the schemes' Registrar and Transfer Agent (R and T). Some AMCs prefer to handle this role on their own instead of appointing R and T. The Registrar or the AMC as the case may be maintains an account of the investors' investments and disinvestments from the schemes. Requests to invest more money into a scheme or to redeem money against existing investments in a scheme are processed by the R and T.

Regulatory Regime

A mutual fund is a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments. The regulation of mutual funds operating in.

India falls under the purview of the authority of the Securities and Exchange Board of India ("SEBI"). Any person proposing to set up a mutual fund in India is required, under **the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 ("Mutual Fund Regulations")** to be registered with the SEBI.

Types of Mutual Fund Schemes



(A) Functional

(i) **Open-Ended Schemes :** Funds available for subscription all the year round excluding the period of book closing are open-ended schemes. These schemes do not have a fared maturity and the units can be sold or bought on any day at a price calculated based on the NAV (Net Asset Value). NAV is the per unit market value of the assets of the scheme minus its liabilities. The most popular example is Unit 64 of the UTI.

(ii) **Close-Ended Schemes :** Schemes have a stipulated maturity period are close ended schemes. Direct investment in such schemes can be done at the time of the initial issue and thereafter buying or selling can be done through the stock exchanges where the scheme is listed. The maturity period may range between 2 to 15 years. The market prices are expected to be equal to the NAV, but for obvious reasons they are seldom equal to the NAV, and most of the units are quoted much below to the NAV. Kothari Pioneer Tax shield, UTI Market Equity Plan 99, Morgan Stanley Growth Fund, Sundaram Tax Saver etc. are examples of close ended schemes.

(B) Charges on Investors

(i) **Load Fund Schemes :** Mutual fund schemes that collect charges from the investors at the time of entry, exit or both are called load fund schemes. If the charge is collected at the time of entry it is front -end load and if it is collected at the time of exit it is called repurchase or back-end load.

(ii) No-Load Fund Schemes : Schemes that do not collect any such charges are no-load fund schemes.

(C) Investment Objective

(i) Income Schemes : Income schemes seek to provide regular and steady returns in the form of dividends. These schemes invest in fixed debt securities as well as money market instruments. These schemes are ideal for investors who need some regular income to supplement their earnings. Alliance Monthly Income Plan, HDFC Income Fund, Escorts Income Plus, Kothari Income Builder, Templeton India Income Fund etc. are examples.

(ii) Growth Schemes : Growth schemes aim to provide capital appreciation over the period of investment. These Schemes normally invest a majority of its funds in equities and convertible debentures. These schemes are meant for investors seeking growth over the long term. Can Expo, Franklin India Growth Fund, HDFC Growth Fund, ING Growth Portfolio, Kotak Mahindra K 30, Zurich Capital Builder, etc. are examples.

(iii) Balanced Schemes : These schemes aim to provide both growth and income by periodically distributing a part of the income and capital gains they earn. They invest in both shares and focused income securities in the proportion stated in their offer documents. These schemes are ideal for investors looking for a combination of income and moderate growth. Cantriple, DSP Merill Lynch Balance Fund, Dundee Balance Fund, Kothari Balanced Fund, Tata Balance Fund, etc. are examples.

(iv) Tax Saving Schemes or ELSS : These schemes offer tax incentives to the investors under the Income Tax Act, 1961. Previously deduction of income under Section 80CCB were allowed in respect of the investment made in ELSS. However, various pension schemes, unit-linked insurance schemes, etc. are other schemes, which can be categorized under this category. Alliance Tax Relief, BOB ELSS 96, Escorts Tax Plan, Kothari Pioneer Tax shield, Tata Tax Savings, UTI Equity Tax Savings Plan etc. are examples.

(v) Index Funds : Schemes that attempt to replicate the performance of a particular stock market index such as the BSE Sensex or the NSE 50. The returns offered are linked with the changes in the index. These schemes are ideal for investors who are satisfied with an equivalent return that of an index. These schemes gather importance now a days due to the present capital market position. UTI Master Index Fund, UTI Nifty Index Fund, Franklin India Index Fund etc. are examples.

(vi) Sector Funds : These schemes invest in securities of a specified sector of an industry or market. The risk and potentiality of the specific sector would be reflected in these funds. Sector fund schemes are ideal for investors who have already decided to invest in a particular sector or segment. Alliance Basic Industries, Kothari Pioneer InfoTech, Kothari Pioneer FMCG Fund, Tata Life Sciences and Technologies, Internet Opportunities Fund, UTI Growth Sectors Fund, etc. are some examples.

(vii) Assured Return Schemes : SEBI allows only those mutual funds that have a track record of 5 years to launch guaranteed funds. The guarantee of return can be given only for one year at a time with postdated cheques.

(D) Nature of Investment

(i) Financial Asset Fund Schemes : Generally mutual funds are investing their funds in the financial assets like shares, bonds and government securities. The broad classifications are equity funds, bond funds and money market funds.

(ii) Bond Fund or Gilt Fund Schemes : Schemes to pass the advantages of debt markets to the investors by investing in a variety of bonds and debentures are Bond Schemes. These carry less risk as compared to foods that have equity shares in their portfolio. Magnum Bond Fund, UTI Bond Fund, Birla Gilt Plus, etc are examples.

(iii) Money Market Schemes : Funds invest wholly in money market instruments such as treasury bills, certificates of deposits, commercial papers and bill discounting. These funds aim to provide easy liquidity, preservation of capital and moderate income. These schemes are meant for corporate and individual investors to invest their surplus funds for a short period. IDBI Principal Money Market Fund, Kothari Pioneer MMF, UTI Money Market Fund, etc. are examples.

(iv) Physical Asset or Commodity Fund Schemes : Mutual Funds can also invest the funds in physical assets, which specialize in investing in different commodities directly or through shares of commodity companies or through commodity futures contracts. Common examples are gold funds, other precious metals or real estate's funds.

(E) Geographic Scheme

(i) Domestic Mutual Fund Schemes : Schemes launched with a view to mobilize savings of citizens of the country are domestic schemes. Almost all the schemes offered by the mutual funds other than the offshore schemes are domestic schemes.

(ii) Offshore Schemes : Mutual fund schemes launched with a view to mobilize the savings of foreign countries for the purpose of investment in the Indian securities are offshore securities. The amount shall be mobilized in foreign currencies. These schemes are the doors to the Indian capital market to the foreign investors. India Fund of UTI, morgan Stanley India Investment Fund, Jardine Fleming India Fund, LG India Fund, etc. are examples.

Advantage of Mutual Fund

(i) Professional Management : Professional asset managers carefully select the securities in which they invest. Asset managers also employ a group of analysts and experts that produce detailed information set on which the managers rely in order to select securities. These calls are also based on the investment objective of the fund as well as the risk tolerance.

(ii) Diversification : Mutual fund can hold hundreds or thousands of different securities among different companies, sectors and regions. This diversification allows investors to reduce the risk of a particular stock or sector. The main point here is that by investing in a mutual fund, single investors with small amounts get access to a diversified pool of securities, which they would not be able to do by their own means.

(iii) **Lower Cost :** The cost for a single investor to buy stocks or bonds through a mutual fund is much lower than investing individually so as to create a diversified portfolio. This is due to the fact that the cost of accessing to the detailed information and analysis of professional management stated above is being shared among thousands of investors.

(iv) **Higher Return :** Mutual funds have the potential to provide a comparative higher return as they invest in a diversified portfolio.

(v) **Easy Liquidity :** Liquidity is an important consideration for any investor. Mutual fund investment offers enough liquidity to investors. In the case of open-ended schemes money invested can be received back from the mutual fund itself at NAV related prices. In the case of listed close-ended schemes the units can be either sold at the prevailing market prices or avail of the facility of direct repurchase at NAV related prices fixed by the mutual fund.

(vi) **Transparency :** Regular and periodical information on value of investment can be received by the investors in addition to disclosure on the specific investments made by the scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

(vii) **Tax Benefits :** Mutual funds as well as investors can enjoy certain tax benefits. Any income of a notified mutual fund is fully exempt from tax under Section 10 (23D) of the Income Tax Act, 1961. Income of mutual funds by way of dividends, interests, etc. on investment or capital gains will be exempt from payment of Income Tax. The UTI is also not liable to pay any tax is respect, of any income, profits or gains.

(viii) **Choice of Schemes :** Mutual funds are floating different schemes with a variety of investment objectives. This creates an opportunity among investors to choose the schemes on the basis of their objectives, motivations, and requirements.

Disadvantage

(i) **Higher Risk :** All mutual funds are subject to risks and those that depend primarily to stock markets have higher risks. Of course the potential for higher returns is also higher than in funds that invest in debt markets and government securities, where there is lower risk profile with steady income.

(ii) **Our Fund Managed by Others :** An investor in a mutual fund has any type of control over the portfolio management. Investor loses the right of building his own portfolio of shares and securities as it is delegated to the fund managers and just rely on the due diligence of the fund managers.

(iii) **Difficulty of Choosing From :** As a large number of mutual fund schemes are available the investor has to make a correct choice. He may need advice of experts on how to select a fund, which satisfies his investment objectives, which is quite similar in the case of direct investing in the share market.

(iv) **Volatility :** A mutual fund unit price changes due to the fluctuations of the underlying securities. Mutual funds cannot guarantee a certain return or a certain return on capital. In most of the cases investors have to pay management, sales and any other operational fees irrespective to the performance of the fund. If an investor is very risk averse and needs absolute guarantee, it would be better to invest in more traditional banking products.

(v) **Authorization Procedures :** If an investor wants to include specific stocks and bonds in their portfolio, the mutual funds are not a suitable solution for them. Mutual Funds are considered to be successful investment vehicles because they spread the management costs to all portfolio investors. Thus, they cannot take into consideration the specific needs of individual investors. Also, they cannot satisfy investors who want to trade specific shares or bonds.

History of Mutual Funds In India

The origin of mutual fund industry in India is with the introduction of the concept of mutual fund by UTI in the year 1963. Though the growth was slow, but it accelerated from the year 1987 when non-UTI players entered the industry.

The mutual fund industry can be broadly put into four phases according to the development of the sector. Each phase is briefly described as under.

(i) **First Phase-1964 to 1987 (Establishment and Growth of UTI) :** Unit Trust of India (UTI) was established on 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was delinked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964.

(ii) **Second Phase-1987 to 1993 (Entry of Public Sector Funds) :** Entry of non-UTI mutual funds, SBI Mutual Fund was the first followed by Can bank Mutual Fund (Dee 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92).

(iii) **Third Phase-1993 to 1996 (Introduction of Private Sector Funds) :** In the history of mutual funds, a new era was started with the entry of Private Sectors in the mutual funds industry during 1993 - 1996. During this period private domestic and foreign players were allowed in the mutual fund industry. Finally, in the year 1992-93, the Government allowed Private sector player to set up the Mutual Fund. As a result, a number of private sector mutual funds came up. With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund family.

Thus, it was the phase of Private Sector funds entering in Mutual Fund Market thereby affecting investors, providing sufficient choice of fund, numerous managers as well as a big flow of funds.

(iv) **Fourth Phase-1996 to 2003 (Era of SEBI Regulations) :** Although, in the year 1993 the Securities Exchange Board of India (SEBI) notified regulations bringing all Mutual Funds except UTI under a common regulatory frame work by issuing the Mutual Fund Regulations, but the Mutual Fund industry observed strong growth and strict regulation from SEBI after 1996 only. The number of operators of Mutual fund and thereby mobilization of funds increased as investors started investing more in Mutual funds. Due to these, protecting the investor's interest became an

urgent need which has been catered by SEBI by introducing SEBI (Mutual Funds) Regulations, 1996.

(v) Fifth Phase-Since 2004 (Consolidation-Mergers-Schemes) : After the year 2003, during this phase, the flow of funds into the mutual funds industry considerably increased. This was due to tax benefits and improvement in quality of investor service which has resulted into a positive growth in the mutual fund industry in India. However, in the year 2003, due to the revocation of the Unit Trust of India Act, 1963, UTI was bifurcated into two separate entities.

This Phase is known for division of UTI into separate entities. The phase had harsh experience for UTI. It was divided into two separate entities. One is the Specified Undertaking of the Unit Trust of India; running under the supervision and the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations. The Second is the UTI Mutual Fund Ltd, sponsored by SBI State Bank of India, PNB- Punjab National Bank, BOB - Bank of Baroda, and LIC (Life Insurance Corporation) of India. It is registered with SEBI and function under the Mutual Fund Regulations.